First Trust

Quarterly Market Overview

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We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

Time to take stock of the market

The 2021 Summer Olympics are set to open in Tokyo on July 23rd. In addition to seeing which athletes take home the medals, it is always interesting to see if any world records are broken. Shorter track and field events (only run in one direction), such as the 100 meter sprint, have to factor in whether or not runners are being aided by a tailwind. The maximum legal wind assistance is two meters per second. Anything above that and the time would not qualify for world record status, according to Elite Feet. The stock market, on the other hand, is an entirely different story. Tailwinds are allowed and new records are being set frequently. In fact, the S&P 500 Index closed at another record high (4,297.50) on 6/30/21. While there may be more than just one tailwind at work these days, we have to put Federal Reserve ("Fed") monetary policy at the top of any list.

In many respects, this is not your parent's Fed. It has been artificially depressing interest rates and Treasury yields since the 2008-2009 financial crisis through its policymaking and bond buying programs (quantitative easing). Oh, and it has also become far more transparent about its thoughts and actions. From December 2008 through June 2021, the federal funds target rate (upper bound) stood at 0.25% for approximately eight years and three months of that 12.5 year period. That is an aggressive posture to hold for such a long duration. Due to the COVID-19 pandemic, it remains at 0.25% today. For comparative purposes, the federal funds target rate had averaged 4.50% for the 20-year period ended 12/31/08, according to its own data. While the Fed's ultra-easy monetary policy has benefitted consumers in some ways, such as low mortgage rates, it has also undoubtedly forced savers and investors to assume additional market and credit risk to achieve higher returns, in our view.

Think of it this way. In the past, when the stock market experienced a multi-year bull run, it was more than likely accompanied by a relatively strong, if not, robust economy. Strong growth would be the Fed's cue to tighten monetary policy (short-term rates) to help mitigate any potential inflationary pressures, which in turn would usually push bond yields higher over time. That is what is missing in the current bull market. While we do not think that the stock market has peaked by any stretch, the fact that interest rates and bond yields are at such low levels means the number of alternative options for investors, not to mention savers, are fewer and fewer.

The table positioned at the upper right of this page illustrates this point. Again, we are not saying the bull market is ending anytime soon, but two that did end in this millennium are featured in the table. The recent pop in inflation notwithstanding, compare today's paltry interest rates and bond yields with those in 2007 and 2000. Investors were getting a much higher return for the amount of risk they were assuming than in today's climate. The bond yields in 2007 and 2000 were high enough that they were competitive with the historical returns on stocks. The ICE BofA U.S. Corporate Index of investment-grade bonds yielded more than three times what it does today back on 3/24/00. Back then, investors had very attractive alternatives to shift their capital to if they wished to reduce their exposure to equities.

Where interest rates/yields stood at the end of two prior bull markets

Day Bull Market Ended (S&P 500 Index)	6/30/21 *(Ongoing)*	10/9/07	3/24/00
Fed Funds Target Rate	0.25%	4.75%	6.00%
CPI Headline Rate (Y-O-Y NSA)	5.4%	3.5%	3.8%
10-Year T-Note	1.47%	4.65%	6.19%
22+ Year U.S. Municipal	3.39%	4.99%	5.95%
U.S. Corporate	2.11%	5.97%	7.83%
U.S. High Yield Constrained	4.62%	8.57%	11.88%

*Source: Bespoke Investment Group, Bloomberg. Consumer Price Index (CPI) data is month-end. Bond indices are from ICE BofA. **Past performance is no guarantee of future results**.*

Having said all of that, we believe that equity investors still have the fundamentals on their side. The Fed has implied that it is not likely to begin tightening monetary policy until 2023, which is 18 months away. The Fed has rarely, if ever, offered up this much valuable guidance. It will likely begin tapering its monthly bond buying program ($80 billion of Treasuries and $40 billion of mortage-backed securities) well before it adjusts interest rate levels. The yield on the 10-year Treasury note stood at 1.47% on 6/30/21 (see table), 160 basis points below its 3.07% average for the 20-year period ended 6/30/21, according to Bloomberg. It has a long way to go before its yield begins to compete with stock returns.

Corporate America is cash rich. The companies in the S&P 500 Index are flush with cash. Cash holdings, which include short-term investments and long-term marketable securities, reached $2.03 trillion in May 2021. The sectors holding the most cash were as follows: Information Technology ($587.7 billion); Communication Services ($345.2 billion); Consumer Discretionary ($294.9 billion); and Health Care ($288.4 billion); according to Bloomberg. In addition to having capital, companies appear to be investing it more effectively.

Data from Credit Suisse indicates that cash flow return on investment (CFROI) at U.S. companies is projected to approach the 10% level by 2022. Historically, that figure averages closer to 6% per year. CFROI measures cash flow relative to a company's cost of capital.

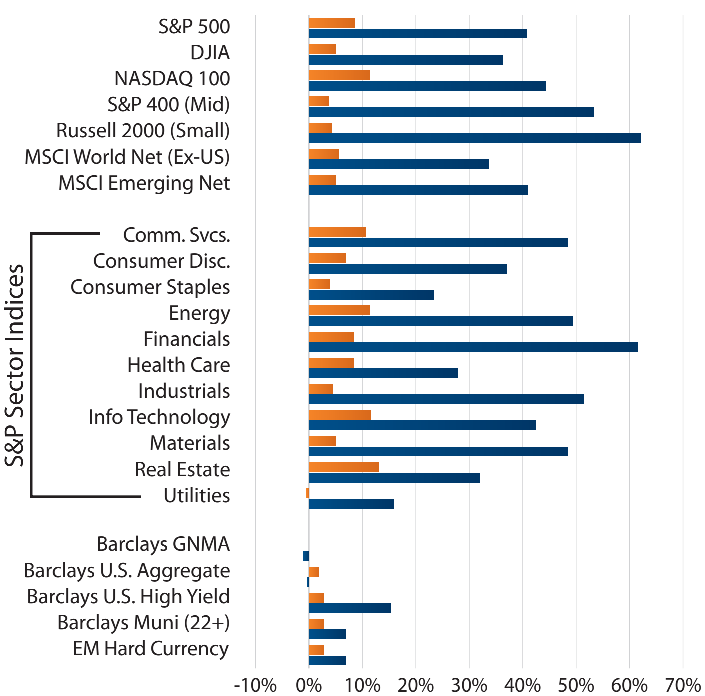
Earnings season is about to begin for Q2'21. Year-over-year comparisons should be excellent. Remember, the economy in Q2'20 was hit extremely hard by the surge in COVID-19 cases. Bloomberg's consensus earnings growth rate estimate for the S&P 500 Index in Q2'21 was 63.45% as of 7/2/21. Its year-over-year estimates for 2021 and 2022 were 35.94% and 12.41%, respectively. Those estimates are well above where bond yields sit these days and that is still a potential tailwind for stocks. For more statistics on the current climate for stocks (S&P 500 Index), see page 2.

Some interesting tidbits about the S&P 500 Index

- The S&P 500 Index ("index') represents roughly 80% of available U.S. market capitalization and has over $11.2 trillion indexed or benchmarked to it.
- The index is comprised of 11 major sectors and 124 subsectors, or industries. These statistics change over time.
- From 1926-2020, the index posted an average annual total return of 10.3%. When people say stocks go up about 10% a year, this is the stat they are quoting.
- In the first half of 2021, the S&P 500 Index posted a total return of 15.3%, considerably more generous than its 10.3% annual average since 1926.
- Over those 95 calendar years (1926-2020), the index finished the year in positive territory, on a total return basis, in 70 of the 95 years, or 73.7% of the time.
- Of the 25 years that generated negative calendar year total returns, 19 of them happened prior to 1990.
- The average return over the 70 years in which the index finished in positive territory was 21.2%, compared to -14.1% for the 25 down years.
- From 1996-2020 (25 years), an average of 312 stocks in the index, or 62.4%, were up each year on a price-only basis (dividends not included).
- Money managers seeking to outperform the index can begin by limiting their exposure to the 37.6% of stocks that fall each year. Easier said than done.
- The S&P SPIVA U.S. Scorecard (year-end 2020) stated that 82.3% and 94.0% of "All Large-Cap Funds" failed to beat the S&P 500 over the past 10 and 20-year periods.
- How is volatility tracked? The Cboe Volatility Index® (VIX® Index) is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX℠) call and put options.
- For the 25-year period ended 6/30/21, the average reading on the VIX® Index was 20.4. The low for the period was 9.1 (11/3/17). The high was 82.6 (3/16/20). The lower the reading the better. The VIX® Index closed trading on 6/30/21 at a reading of 15.8.
- Stock buybacks have been a big topic in the market for the better part of the last decade or so. Ideally, the goal of repurchasing stock is to boost a company's earnings-per-share results by reducing outstanding share count. For the 10-year period ended 3/31/21, S&P 500 buybacks totaled $5.6 trillion.
- Over that 10-year span, Information Technology, Financials, Consumer Discretionary, Health Care and Industrials were far and away the most active participants buying back stock valued at $1.6 trillion, $992.5 billion, $736.6 billion, $727.6 billion and $580.5 billion, respectively.
- As of 6/30/21, 386 companies in the index distributed a quarterly dividend. Based on year-end data, that stood well below the 469 companies that paid one in 1980.
- Information Technology, Health Care, Financials, Consumer Staples and Industrials contributed the most to the index's dividend payout at 17.1%, 15.1%, 13.8%, 11.1% and 8.5%, respectively, as of 6/30/21.
- With respect to valuation, as measured by its price-to-earnings (P/E) ratio, the index registered an average P/E of 17.1 for the 50-year period ended 6/30/21. The index's trailing 12-month P/E stood at 30.3 on 6/30/21. On a forward-looking basis, thanks to double-digit earnings projections, the estimated P/Es look less rich.
- Bloomberg's 2021 and 2022 year-end P/E estimates for the index were 22.8 and 20.4, respectively, as of 7/9/21.

Sources: S&P Dow Jones Indices, S&P Compustat, Morningstar/Ibbotson Associates and Bloomberg. ***Past performance is no guarantee of future results.***

Total returns for Q2 and past 12 months (6/30/21)



Sources: Bloomberg and Barclays. ***Past performance is no guarantee of future results.***

A Look Ahead:

A year-over-year earnings comparison in U.S. dollar terms (per share). The S&P 500 Index dollar figures reflect the 11 major sectors on a weighted-adjusted basis.

Index (Weighting In S&P 500)	**Q3'21E**	Q3'20A	**Q4'21E**	Q4'20A	**2021E**	2020A
Communication Svcs. (11.1%)	**2.58**	1.95	**2.95**	2.03	**11.16**	7.26
Consumer Disc. (12.3%)	**10.06**	11.41	**10.55**	8.72	**39.66**	28.29
Consumer Staples (5.9%)	**9.00**	9.35	**8.69**	7.42	**33.39**	32.05
Energy (2.9%)	**6.13**	-1.65	**5.87**	-8.53	**20.54**	-27.58
Financials (11.3%)	**9.74**	11.72	**10.09**	14.39	**44.65**	32.66
Health Care (13.0%)	**20.51**	15.26	**20.05**	13.66	**79.68**	57.93
Industrials (8.5%)	**8.74**	4.62	**9.39**	3.02	**31.26**	13.59
Information Tech. (27.4%)	**22.42**	16.23	**26.78**	22.79	**91.54**	67.79
Materials (2.6%)	**7.76**	3.84	**6.91**	5.13	**28.74**	15.86
Real Estate (2.6%)	**1.29**	0.98	**1.34**	1.50	**5.48**	5.28
Utilities (2.5%)	**5.41**	4.88	**3.45**	3.52	**17.18**	15.60
S&P 500 Index	**46.75**	37.90	**48.99**	38.18	**187.29**	122.37
S&P 400 Index (Mid-Cap)	**35.82**	19.70	**36.86**	28.79	**138.63**	74.17
S&P 600 Index (Small-Cap)	**16.92**	8.59	**19.03**	13.11	**66.54**	-3.99

Source: S&P Dow Jones Indices (6/29/21). Sector weightings as of 6/30/21.
There is no guarantee past trends will continue or projections will be realized.

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